

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

July 20, 2004

The Capital Projects and Bond Oversight Committee met on Tuesday, July 20, 2004, at 1:00 PM, in Room 129 of the Capitol Annex. Senator Robert Leeper, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Robert Leeper, Co-Chair; Senators Tom Buford, Virgil Moore, and Jerry Rhoads; and Representatives Paul Marcotte and Jim Wayne.

Guests testifying before the committee: Jody Hughes, John Covington, and Sandy Williams, Kentucky Infrastructure Authority; Tom Howard, Office of Financial Management; Bill Hintze, Governor's Office for Policy and Management; Jim Abbott and Steve Biven, Finance and Administration Cabinet; Linda Pittenger, Department of Education; Jim Owens, Department of Fish and Wildlife Resources; Deborah Wilkins, Western Kentucky University; and Bob Wiseman and Dick Siemer, University of Kentucky.

LRC Staff: Mary Lynn Collins, Pat Ingram, Nancy Osborne, Kevin Mason, and Shawn Bowen.

Representative Marcotte made a motion to approve the minutes of the June 15, 2004 meeting as submitted. The motion was seconded by Senator Buford and passed by voice vote.

Senator Leeper called on Ms. Collins to review correspondence and information items. Ms. Collins said members' folders contained three items of correspondence: quarterly status reports on authorized capital projects; the Kentucky Lottery Corporation's monthly financial report for May 2004; and correspondence from the Auditor of Public Accounts submitting an audit on lease law compliance by the Finance and Administration Cabinet during fiscal years 2002 and 2003.

Ms. Collins said the Auditor concluded in the report that the leases examined were in conformity with KRS 56.823 in all material aspects. However, the Auditor found one lease from 2002 that had not been submitted to the Committee for approval. Ms. Collins also noted that the Auditor's Office, in the past, had reviewed leases from the University of Kentucky (UK) and the University of Louisville (UL), but in this report, the review was limited to leases executed by the Finance and Administration Cabinet.

Representative Wayne asked who does an objective review of the university leases. Senator Buford said he was not sure the Auditor has the responsibility to check the university leases unless it is statutorily directed. Ms. Collins said the statute directing the review of leases specifies the Finance and Administration Cabinet, but it does not specify the postsecondary institutions. However, she said in the past, UK and UL leases have been reviewed by the Auditor's Office.

Representative Wayne said over the years, universities have evolved into nearly autonomous-functioning organizations, and the Auditor's role is to make sure the dollars are being spent wisely. He said if there is no oversight on these leases, the Committee needs to know, and perhaps propose legislation to assure adequate review.

Senator Leeper asked the staff to send a letter to the Auditor, asking her position on this matter.

Senator Leeper said in May, the Committee reviewed a Kentucky Infrastructure Authority (KIA) bond issue that would restructure the Governmental Agencies Program (Fund C) debt. For that reason, the Committee asked Jody Hughes, the new KIA Executive Director, to appear before the Committee today to discuss plans being considered for this program.

Mr. Hughes introduced Mr. Tom Howard, Deputy Executive Director, Office of Financial Management (OFM) and Mr. John Covington, KIA Analyst. Mr. Hughes said by restructuring the Fund C program, 73 borrowers with 100 loans had their total debt service payments reduced by \$20 million.

Mr. Howard said in order to restructure the program, KIA was required to defease all existing bonds. To accomplish this, KIA issued \$25,640,000 in tax-exempt bonds, and \$17,375,000 in taxable bonds to defease the callable bonds outstanding. Mr. Howard said, overall, present value savings of approximately \$1,509,470 or 3.73% were achieved.

Mr. Howard said the debt service savings from the tax-exempt bonds would be allocated to the borrowers. The restructuring cost of the taxable transaction was borne by excess funds in a surplus account, to no detriment of any borrower in the program. The borrowers have been able to lower their debt service payments. In addition, Mr. Howard said they eliminated the need for borrowers to have a debt service reserve fund (DSRF). Previously, participants borrowed the additional amount they needed for a DSRF and made a semi-annual payment over 20 years to pay off the reserve fund, and received a credit at the end.

Mr. Howard said under the old indenture, this transaction would have been rated A-, which is based solely upon the moral obligation credit of the state. They have

lowered borrowing costs by upgrading the credit from A- to AA using Standard and Poor's pooled loan criteria, which is worth 30 basis points (.3%) to the borrower. They have also eliminated the state's moral obligation to appropriate debt service if there is a shortfall.

Mr. Howard said they would not know the final values until August because they have some liquidation to do and need to sort out the investments in the DSRF. In the future, the program will have lower borrowing costs because there is now no DSRF requirement, and they will be able to subsidize loans. Also, KIA will be able to make loans to a variety of infrastructure projects.

Mr. Covington reviewed a list of the outstanding Fund C loans, including old and new debt service amounts and aggregate savings. He said there has been considerable savings to each borrower by restructuring the program. He said they wanted the restructuring to accomplish three goals: (1) provide benefit to KIA's existing borrowers; (2) improve the program and make it more attractive to new borrowers; and (3) provide simplification of the Fund C administrative process. He said they are looking at various options of how to subsidize their current loan rate by as much as 100 basis points (1%). Mr. Covington said with the new census data and guidelines for the federal Rural Development program, there will be significantly fewer communities eligible for that subsidized rate and grant program. He said KIA hopes to have a program that is comparable to the federal Rural Development program without its restrictions.

Senator Buford asked about Kentucky's bond rating. Mr. Howard said Moody's has Kentucky on a watchlist for a potential downgrade, pending resolution of the budget situation. He said Standard and Poor's (S & P) has also noted that Kentucky is of particular concern, but given recent court activity, deferred action. Fitch has not commented, nor have they published any commentary regarding Kentucky's bond rating.

In response to a question by Senator Buford, Mr. Howard said the rating agencies like the fact that the state has set aside all of the needed debt service payments for the current year, and that may be what is keeping the state's bond rating from being downgraded.

Representative Wayne asked if there are guidelines that will no longer have to be followed under the new Fund C program. Mr. Howard said the approval process will remain the same – projects will be reviewed and approved by the KIA Board, OFM, the State Property and Buildings Commission, and the Capital Projects and Bond Oversight Committee.

Senator Leeper asked if there are limitations or restrictions on the types of projects to be funded. Mr. Howard said the projects will be the same – they need to be revenue-producing infrastructure projects. Mr. Covington said while the majority of Fund C

projects have been water and sewer, the KIA statutes do not restrict funding to water and sewer projects.

Mr. Bill Hintze, Deputy Budget Director, Governor's Office for Policy and Management, next discussed the VETS Building Replacement project at the Boone National Guard Center for the Department of Military Affairs. [This project was reviewed by the Committee at its June meeting for a scope increase of \$75,000 from the Department of Military Affairs' Maintenance Pool Funds. At that time, the Committee voted to delay action on this project until its July meeting.]

Mr. Hintze said this project, originally approved by the Committee last February at a scope of \$1,100,000 (\$825,000 federal funds and \$275,000 Maintenance Pool funds), is substantially dependent upon time-limited federal funds. The time limitations are extremely stringent, and the project must be under construction by September 30. He said normally this would be an impossible task, but due to expedited procedures used in the design process, they are hopeful they can meet that date, and not forfeit the federal funds to another state. He said when those facts were presented to Finance Secretary Rudolph, he exercised his authority under KRS 45.800, and authorized the project to proceed.

Senator Leeper asked Mr. Hintze and Mr. Jim Abbott, Commissioner, Department for Facilities and Support Services, to present the Finance Cabinet's monthly report to the Committee. Mr. Hintze reported a scope increase of \$1,100,000 (\$715,000 federal funds and \$385,000 agency funds) for the Thomson-Hood Veterans' Center project to renovate/relocate the Special Care Unit.

Senator Buford made a motion to approve the scope increase for the Thomson-Hood Veterans' Center project. The motion was seconded by Senator Moore and passed by unanimous roll call vote. The revised project scope is \$3,950,000.

Mr. Hintze next discussed a project for the Kentucky Department of Education known as an Information Technology System in support of an Individual Learning Plan Tool for Kentucky Students. Mr. Hintze said this project is 100% federally funded, and the cost may exceed \$400,000, the threshold for a capital project. The project will allow the establishment of a contract for program development, systems integration services, and a range of service applications. The program will be a web-based planning tool to help students starting in the sixth grade work toward meeting college/university or other postsecondary requirements.

Senator Leeper asked what other activities could be funded with these funds since the federal funding source for this project is discretionary administrative funds. Ms. Linda Pittenger, Director, Division of Virtual Learning, Kentucky Department of Education, said these funds are Title I funds and are to be used to support disadvantaged students, and to promote college attendance and successful transition from high school.

She said if they were not able to go forward with this application, those funds would likely be made available for other activities such as professional development to serve the same purpose. She said the plan is done manually right now, and by making it web-enabled, it would allow more people to be involved in the advising function.

Senator Moore made a motion to approve the Kentucky Department of Education Information Technology System project. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote.

Mr. Hintze reported an allocation of \$680,500 for a land acquisition project for the Commerce Cabinet, Department of Fish and Wildlife Resources. Mr. Hintze said the Department plans to acquire 328 acres of property contiguous with the Boatright Wildlife Management area in Ballard County.

In response to a question from Senator Leeper, Mr. Jim Owens, Department of Fish and Wildlife Resources, said once this property is acquired, it will become part of the Boatright Wildlife Management area.

Mr. Abbott then discussed an \$949,792 Energy Savings Performance Contract (ESPC) for the London and Madisonville State Office Buildings. Vestar, a subsidiary of Cinergy in Cincinnati, Ohio, will install energy conservation measures in the two buildings. The conservation measures include window replacements at both locations; light fixtures/ceiling replacements and boiler replacement at the London facility; and roof replacement at the Madisonville facility.

Mr. Abbott said they had initially planned to replace these two buildings at an estimated cost of \$20 million each. He said both of the buildings are good structures, which just needed a lot of work to secure the envelope to accommodate the existing tenants.

Senator Leeper noted that the Office of Financial Management cashflow analysis assumes that \$791,572 is scheduled operation and maintenance funds. He asked how this was determined. Mr. Abbott said the money being used to underwrite this project is operational funds for the Department for Facilities and Support Services. He said this is the first time they have approached an ESPC in this manner.

In looking at the funding savings over the duration of the project, Mr. Abbott said an error was made in the contract that was established with Vestar. The guarantee that is part of the contract only runs for ten years, but according to the cash flow analysis, and excluding the \$791,572 budgeted for operations and maintenance, it will take 11 ½ years for the project to achieve a positive cash flow. However, Mr. Abbott said the company normally only guarantees 80% of their projected energy savings, and he believes the savings will be there.

Senator Leeper noted there was a 23.5% contractor mark-up on this project. He asked if that is typical for an ESPC. Mr. Abbott said they consider a mark up in excess of 25% as being out of scope.

In response to another question from Senator Leeper, Mr. Abbott said there are two offices that audit and review ESPCs - OFM and the Division of Engineering.

In response to a question from Senator Rhoads, Mr. Abbott said the London State Office Building has some vacant space, and the Madisonville State Office Building is fully occupied. He said both buildings should be fully occupied following the renovation of the buildings.

Senator Rhoads said the Madisonville facility, the old TB Hospital, has been well maintained, and this is a prudent decision because the building is structurally sound. Senator Leeper said no further action was required for this project.

Ms. Deborah Wilkins, General Counsel, Western Kentucky University (WKU), discussed two projects for WKU. Ms. Wilkins said WKU plans to renovate Van Meter Overlook and construct an arboretum in front of it. The scope of the project is \$1,400,000. A local contractor will provide "gift-in-kind" work valued at \$400,000, and a donor will provide \$1,000,000 to make the improvements.

Representative Wayne asked how the University's lawyers interpret Franklin Circuit Court Judge Roger Crittenden's ruling that "pending the final disposition of this litigation, no funds shall be expended on capital projects not previously authorized by the General Assembly." Ms. Wilkins said as General Counsel for the University, it was her opinion that the Judge's order does not apply to private donations. The funds will flow through the foundation, and the foundation will give the money to the University to let the contracts.

Representative Wayne said he was skeptical about approving anything in light of the lawsuit underway regarding the budget. He said this project should not be done at this time, and we should be as cautious and conservative as possible.

Senator Buford made a motion to approve the unbudgeted project to renovate Van Meter Overlook and construct an arboretum in front of it. The motion was seconded by Senator Rhoads and passed by roll call vote. Five members voted affirmatively; Representative Wayne voted "No".

Ms. Wilkins next discussed plans by WKU for an unbudgeted project to make improvements to its baseball facilities. She said the City of Bowling Green/Warren County has an opportunity to bring to Bowling Green a minor league baseball franchise.

The City has approached the University about the possibility of using the University's intercollegiate baseball facility as a temporary home for the team for approximately one year until they can construct a permanent stadium. In order for a franchise to use WKU's facility, certain improvements would need to be made.

Ms. Wilkins said the University has examined the proposal and determined it would benefit the University. Ms. Wilkins said the proposal would be a leasehold improvement, a lease between the University and either the franchise owner or the City and County. The cost of the improvements would be \$2,000,000, and would be paid by the franchise. She said the improvements would consist of additional seating, new locker room facilities, new concessions area, and dugout renovations.

Ms. Wilkins said the reason they are bringing this item to the Committee now is because WKU needs to provide some assurance to the City and County that the University will be able to move forward once a franchise owner and a team have been identified.

In response to questions from Representative Wayne, Ms. Wilkins said the prevailing wage law will be applied to both WKU projects before the Committee today.

Representative Wayne said the foundation is supplying the funds for this project, and it is considered an institution under the Open Records and Open Meetings law. Representative Wayne said he felt like WKU was being irresponsible to try to skirt the Judge's order under the circumstances.

Representative Marcotte asked if WKU would need such a large stadium after it has been renovated. (Seating would increase from 1,000 seats to 3,000 seats.) Ms. Wilkins said WKU's baseball team will continue to utilize the stadium, and will also host conference tournaments.

In response to a question from Senator Moore, Ms. Wilkins said this project does not affect the state budget in any manner.

Senator Buford said KRS 45.760(14) supports the University's position for continuing with this project. The statute provides that a capital construction project may be authorized even though it is not specifically listed in the Appropriations Act if 50% or more of the actual cost is funded by federal or private funds. In this case, private funds will be used to pay 100% of the project.

Senator Buford made a motion to approve the WKU Baseball Facility Improvements project. The motion was seconded by Senator Moore.

Senator Leeper asked about the risks to WKU. Ms. Wilkins said they do not have a leasehold agreement in place, but it will be the standard leasehold agreement. The University will have no liability, the improvements will be made prior to the franchise team's occupation of the premises, and sufficient financial investors already identified will back them.

In response to questions from Senator Leeper, Ms. Wilkins said subcontractors will not be able to file a lien against WKU if any problems arise during the renovation project. Ms. Wilkins said the only expected cost increase for this project would be an increase in maintenance and operation costs. She said during the term the franchise uses the facility, they will absorb those maintenance and operation costs, and when they vacate, WKU will absorb them into its athletic budget. Ms. Wilkins said the project will be competitively bid, and the University will maintain oversight over the contracts and construction.

Senator Rhoads asked if WKU will be primarily or secondarily liable for the cost of the improvements. Ms. Wilkins said they will not be liable for the cost of the improvements, the University will have a leasehold agreement with the team and franchise owner, and they will have no legal role in the letting of the contracts. However, in the lease, the University will have a provision that gives them the authority to be involved in and have oversight of the construction.

Representative Wayne made a motion to amend Senator Buford's motion as follows: Motion to approve the WKU Baseball Facility Improvements project contingent upon (1) receipt of the agreement between the University and the entity that will finance and manage the improvements to the WKU baseball stadium; and (2) receipt of quarterly status reports on the project. The motion was seconded by Senator Rhoads and the amended motion was adopted by voice vote. The amended motion was then seconded by Senator Moore and passed by roll call vote. Five members voted affirmatively; Representative Wayne voted "No".

Senator Leeper asked Mr. Bob Wiseman, Associate Vice President for Facilities, UK, to present two projects. Mr. Wiseman introduced Mr. Dick Siemer, Executive Vice President for Finance and Administration, UK. Mr. Wiseman reported a \$267,727 privately funded scope increase for the IRIS (Integrated Resource Information Systems) Project Facility Renovation project. This project was approved by the Committee at its May meeting at a scope of \$1,253,000. The scope increase will be used to accept the low bid. Mr. Wiseman noted that the project was originally listed as agency and privately funded, but it is now 100% privately funded using interest earnings on private donations.

Senator Buford made a motion to approve the scope increase. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote. The revised scope of the project is \$1,520,727.

Mr. Wiseman said the second project involves the Boone Faculty Center, which was built in 1986 by private contributions. UK is requesting the Committee to approve a renovation and slight enlargement of the structure. The scope of the project is expected to be \$4,377,000, and the University intends to raise privately all required funding. Mr. Wiseman said currently, the University has over 50% of the private funds committed. He said fundraising would continue for the remaining funds.

Mr. Wiseman said during review of the UK Administration Building at the Committee's last meeting, the University was told it should have funding fully in place before proceeding with any privately-funded capital projects. Mr. Wiseman said there should be occasional exceptions, and the Boone Center is one of those exceptions. The Boone Faculty Center's original supporters are very busy in fund-raising efforts, and the building is self-supporting. In addition, they have already committed approximately \$1,000,000 in excess of the renovation funds needed to establish a long-term maintenance endowment for the building. Mr. Wiseman said approximately \$1,400,000 is spent on conferences held off campus. If the Boone Center was renovated to be able to accommodate groups of 300 to 400, UK could capture some of those funds now leaving the campus. He said these funds could offset the ongoing cost of that building.

Mr. Wiseman said they are continuing to seek private funding for the main administration building, and since the last meeting, the University has had a \$500,000 commitment from a leading corporation in Lexington, and anticipates receiving an equivalent commitment soon. He said they intend to continue with fund-raising efforts while moving forward with the project.

Representative Wayne asked if the University is planning to loan the money to the project in hopes of getting the money paid back through ongoing private donations. Mr. Wiseman said they have over 50% of the donations for this project committed in writing at the present time. For the remaining balance, they will either loan internally or use other private funds available within the University. Mr. Wiseman said in addition, it is important to note that some of the funds committed will come in as pledges over a four-year period. He said they plan to do some internal funding as a loan; but ultimately, their intent is to make the project 100% privately funded.

Representative Wayne asked why this project was not included in UK's capital plan or in the budget request. Mr. Wiseman said this project came up last winter. Mr. Wiseman said this project was left off of the capital plan submitted in advance of the budget process. The University asked that this project and four other projects be included into the budget process while the General Assembly was in session, and as a result of that process, it did get incorporated into the Governor's spending plan.

Senator Leeper said his greatest concern is the fact that last month the Committee was told UK would not bring anymore privately-funded projects before the Committee without written commitments for the money. Mr. Wiseman said he thought there would occasionally be exceptions to this.

Representative Wayne said before any privately-funded capital project is approved by the Committee, written commitments for the money must be in hand. He said this is the policy the Committee voted on and approved several years ago.

Mr. Siemer said the President has access to some private funds that could be used, but this project would deplete those funds. He said the President is aggressively pursuing fundraising for this project, and the economic benefits of this project are clear.

Representative Marcotte said he would feel a lot better about this project if there were written commitments in hand before these privately-funded construction projects begin.

Senator Buford said the legislature does not have the privilege to verify whether or not UK has the monetary commitments for this project, and if the University says it does, he trusts them. He said the University had met the statutory requirements.

Senator Buford made a motion to approve the Boone Faculty Center Renovation project. The motion was seconded by Senator Moore and passed by roll call vote. Five members voted affirmatively; Representative Wayne voted "No".

Senator Leeper said he hoped the University recognized the Committee's concern with this continued problem. Mr. Wiseman said he was not aware this was a Committee policy, but he would talk to Ms. Collins about it.

Mr. Steve Biven, Director for the Division of Real Properties, presented one lease modification report and two lease renewal projects.

Mr. Biven said the Department of Libraries and Archives is acquiring an additional 10,000 square feet of storage space in Franklin County for Administrative Office of the Courts (AOC) documents. The rate for the existing lease at \$3.50 per square foot will be applied, and the additional cost will be \$35,000. Senator Leeper said since the modification is under \$50,000, this project did not require Committee action.

Mr. Biven reported a lease renewal for the Department of Revenue in Boone County (PR-4095). The current lessor requested an increase from \$13.50 per square foot to \$16.37. A competitive bid process was conducted, and it was recommended that this agency continue to lease the space they are located in now since the owner of that property offered the space at the lowest cost.

Senator Buford made a motion to approve the lease renewal for PR-4095. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

Mr. Biven said the final project was a lease renewal for the Cabinet for Health and Family Services (PR-0530). This lease was executed two years ago, but not submitted to the Committee for approval. The oversight was discovered during an audit by the State Auditor's Office. Mr. Biven said the lessor, Kosair Charities in Jefferson County, asked for a rate increase, from \$5.49 to \$7.00 per square foot. A competitive bid was conducted, and there were five bidders responding. However, all but the existing lessor withdrew or did not submit a final bid.

Mr. Biven said although this lease was an oversight in reporting that needs to be corrected, proper procurement procedures were followed.

Senator Leeper asked if any safeguards have been put in place to prevent this from happening again. Mr. Biven said they plan to conduct additional staff training, and the branch manager has implemented a tracking system to monitor leases. Mr. Abbott added that new software recently acquired will also help prevent such oversights in the future.

Ms. Sandy Williams, Kentucky Infrastructure Authority (KIA), next reported two new Fund A loan requests. The first was a \$8,265,703 loan for the City of Lawrenceburg in Anderson County. The proceeds will be used to increase the plant's existing capacity from 1.9 million gallons per day to 3.3 million gallons per day.

Senator Buford made a motion to approve the KIA Fund A loan for the City of Lawrenceburg. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

The second Fund A loan request was in the amount of \$2,087,148 for the City of Loretto in Marion County. The proceeds will be used to construct a new sewer system.

Senator Rhoads made a motion to approve the KIA Fund A loan for the City of Loretto. The motion was seconded by Senator Buford and passed by unanimous roll call vote.

Ms. Williams said included in members' folders were reports from KIA regarding new Tobacco and Coal Development Grants and 2020 projects. No further action was required on these projects.

The next report was provided by Mr. Tom Howard, Deputy Executive Director, OFM. Mr. Howard reported two new bond issues: Kentucky Housing Corporation (KHC) Single Family Housing Revenue Bonds, 2004 Series D & E or additional series as may be

designated in an amount not to exceed \$60 million, and Kentucky Higher Education Student Loan Corporation Student Loan Revenue Bonds, Senior Tax-Exempt Student Loan Revenue Bonds (Series 2004 A-1, A-2 & A-3); Senior Taxable Student Loan Revenue Bonds (Series 2004 A-4, A-5, A-6 & A-7); and Subordinate Tax-Exempt Student Loan Revenue Bonds, Series 2004B-1, \$350,000,000.

Representative Wayne made a motion to approve the two new bond issues. The motion was seconded by Senator Buford and approved by unanimous roll call vote.

Mr. Howard said also included in members' folders were three follow-up reports: Turnpike Authority of Kentucky Economic Development Road Revenue Refunding Bonds (Revitalization projects), 2004 Series A, \$16,180,000; Kentucky Housing Corporation (KHC) Revenue Bonds, 2004 Series A (Non-AMT), Series B (AMT), and Series C (AMT, Variable Rate) \$50,000,000; KIA Wastewater Revolving Fund Program Revenue Bonds, 2004 Series I and Drinking Water Revolving Fund Program Revenue Bonds, 2004 Series C, \$11,300,000; and KHC Housing Conduit Multifamily Mortgage Revenue Bonds, 2004 Series A (Falcon Crest Apartments project.) \$10,965,000.

Also included in members' folders was an escrow restructuring transaction relating to the State Property and Buildings Commission Revenue Refunding Bonds, Project No. 82.

Senator Leeper said no action was required for these reports.

Senator Leeper said one locally-funded school bond issue for Bullitt County was submitted to the Committee for review this month. He said all disclosure information has been filed, and no further action on the bond issue is required.

Senator Leeper said the Committee's next meeting is scheduled for August 17 at 1:00 p.m.

With there being no further business, Senator Moore made a motion to adjourn the meeting. The motion was seconded, and the meeting adjourned at 2:45 p.m.